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RUEHLO/AMEMBASSY LONDON 1802
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C O N F I D E N T I A L SECTION 01 OF 02 ALGIERS 000626

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TAGS: [EPET](#) [ECON](#) [ETRD](#) [PREL](#) [AG](#)
SUBJECT: OPEC CHIEF OPINES ON FUEL PRICES

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Classified By: DCM Thomas F. Daughton; reasons 1.4 (b) and (d).

11. (C) SUMMARY: Algeria's Energy Minister and OPEC President Chakib Khelil told us May 28 that the high price of fuel in the United States has less to do with OPEC production caps than with the value of the dollar, oil speculation and refining techniques associated with bio-fuel additives. Khelil said that countries like Algeria and Iran currently have crude oil surpluses, but he admitted that costs have doubled or even tripled for exploration and production projects in Algeria as material and equipment prices have skyrocketed. Khelil also outlined Algeria's goals to renegotiate its gas commitments with Europe in favor of shorter-term contracts, its efforts to be a commercial gas player in Spain, and its satisfaction with the developing LNG spot market. END SUMMARY.

NOT OUR FAULT

12. (C) In a May 28 meeting at the Embassy, Energy Minister and OPEC President Chakib Khelil asserted that OPEC supply caps were not to blame for the rising price of fuel in the United States. Rather, he lamented that the sub-prime mortgage crisis fueled a weakened dollar, which in turn had encouraged speculators to drive up the price of oil. He claimed that at least USD 40 of the current cost of a barrel of oil was the result of the weak dollar and trading by speculators. He also attributed USD 10 per barrel of oil to the increased use of bio-fuel additives in diesel fuel. According to Khelil, the process of adding a bio-fuel component to diesel fuel has reduced the efficiency of refineries producing diesel, and consequently their production capacities. This has resulted in higher demand for the kind of oil that is refined easily into diesel, he said, driving up the price per barrel across the supply chain.

TOO MUCH OIL?

13. (C) At the same time and for related reasons, Khelil insisted, there is currently an oversupply of oil in some areas. For example, he said, Algeria is having trouble selling all its oil at current production capacity because its oil is most suited for naphtha and gasoline and not in

demand for diesel production. He also said that Iran has so much oversupply that it is currently storing crude in ships because its storage facilities are completely full. High fuel prices and any perceived market shortage, he said, lie in refinery bottlenecks, not in crude oil supply.

HIGH COST OF DOING BUSINESS

14. (C) Khelil admitted that Algeria is burdened by the skyrocketing cost of food and construction materials. He noted that Algeria spends about five billion dollars on food imports each year, and among the sectors within his purview as Minister of Energy and Mines, he has seen the costs of major projects double and even triple over the course of the last few years. He noted that the cost of a new power generation facility to be built by General Electric will reach two billion dollars; an identical facility completed just two years ago cost USD 860 million. He also lamented the long delays in getting materials and equipment for special projects. Khelil said the lead-time to construct an LNG plant has increased from two to four years because of the difficulty in getting the specialized construction materials and equipment needed for such plants.

LOOKING SHORT-TERM

15. (C) Khelil noted strong interest in LNG in the U.S., where currently Algeria is relying on a venture with Statoil to market its product. Algerian oil parastatal Sonatrach is exploring access to the U.S. market, he said, but terminal operators are seeking long-term supply commitments. Khelil

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noted that Algeria is doing well in the LNG spot market and wants to capitalize on those opportunities. For example, he said, Algeria can earn twice as much for LNG sold to Turkey as for gas piped to Spain, and three times as much for sales to Japan. Khelil said that Sonatrach wants to renegotiate its pipeline gas deals in favor of shorter-term contracts. He noted that while the traditional long-term contracts allow for renegotiation of price when market prices rise significantly, the renegotiation process is usually slow and arbitration alone can take two years or more. Thus, he said, it is advantageous for Algeria to enter into five-year contracts and negotiate price according to current market conditions.

16. (C) Khelil spent some time complaining about what he called unfair treatment of Sonatrach by Spain. He reviewed the history of several recent disputes between Algeria and Spain over gas price and commercial market share, and lamented the fact that Sonatrach has only achieved a three-percent share of the Spanish consumer gas market directly through its new commercial entity. He also complained bitterly that even though Sonatrach has a 36-percent interest in the new gas pipeline to Spain, Spanish companies are trying to prevent Sonatrach from exercising its voting rights in the joint venture.

COMMENT: WEARING THE LOCAL HAT

17. (C) Khelil was relaxed and spoke rather freely with us despite the fact that, as oil prices have continued to ascend, access to him has been increasingly difficult to get for both diplomats and corporate leaders. While he acknowledged his role as OPEC president and spoke a bit about general supply and demand issues, he was clearly most interested in discussing Algeria's current situation in relation to other producers, and its goals for future development. He mentioned to us, as he has done in recent speeches and press interviews, his interest in seeing more investment in Algeria by American companies, particularly outside of the hydrocarbons sector. But he offered few

assurances that American companies would find a welcoming business environment in Algeria, and we expect that this ambivalence, which we see across the Algerian government, will only continue as the price of oil pushes higher.

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